STATE OF WASHINGTON
OFFICE OF INSURANCE COMMISSIONER

FINANCIAL EXAMINATION

of

Commonwealth Insurance Company of America
Seattle, Washington

NAIC CODE 10220
DECEMBER 31, 2003

Participating States:
Washington

Order No. G05-41
Exhibit A

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Commonwealth Insurance Company of America of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2003.

Patrick H. McNaughton

Patrick H. McNaughton
Chief Examiner

June 21, 2005

Date

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SALUTATION

Seattle, Washington
June 21, 2005

The Honorable Alfred E. Gross
Insurance Commissioner
Chair, NAIC Financial Condition (E) Committee
Virginia Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, VA 23219

The Honorable Linda Hall, Director
Alaska Division of Insurance
NAIC Secretary, Western Zone
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

The Honorable Mike Kreidler, Commissioner
Washington Office of Insurance Commissioner (OIC)
Insurance 5000 Building
5000 Capital Blvd.
Tumwater, WA 98504-0255

Dear Commissioners and Director:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

Commonwealth Insurance Company of America

of

Seattle, Washington

hereinafter referred to as "CICA" or the "Company," at the location of its parent company's home office, 595 Burrard Street, Suite 1500, Vancouver, BC, Canada V7X1G4. This report is respectfully submitted showing the condition of the Company as of December 31, 2003.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1999 through December 31, 2003 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (Canadian chartered accountants) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2003 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1) Reserve and Reinsurance Deficiencies

a. Reserve Adjustments

CICA writes coverages which place its surplus at considerable risk. In order to adequately protect surplus and to reassure policyholders, its parent provided an agreement which is termed a stop loss treaty (SLT). The Company provided loss data gross of the SLT. This data was used to calculate loss and loss adjustment expense reserves as of December 31, 2003, and produced a reserve estimate of $7,172,000.

The Company's 2003 NAIC Annual Statement contains three items that correspond to these liabilities:

Liability for losses (Page 3, Line 1)	$1,419,483
Liability for loss adjustment expenses (Page 3, Line 3)	$191,450
Provision for unauthorized reinsurance recoverable	$2,035,000

Rounded to the nearest one thousand dollars, the booked items total $3,646,000. However, as presented in 1)b. below, the $2,035,000 provision for unauthorized reinsurance will be returned to unassigned surplus, so the booked items are reduced to $1,610,933. The estimated deficiency of $5,561,000 ($7,172,000 - $1,610,933) flows through net income, resulting in a net reduction of $3,526,000 ($5,561,000 – $2,035,000) being charged to surplus as regards policyholders.

The Company is instructed to increase the liability for loss reserves by $4,655,450 and loss adjustment expense reserves by $905,550 for a total net income reduction of $5,561,000, and to return the $2,035,000 provision for unauthorized reinsurance to unassigned funds, for a net reduction of surplus as regards policyholders of $3,526,000 ($5,561,000 - $2,035,000), in compliance with RCW 48.12.030(2). These changes are shown as examination adjustments numbered 1, 2 and 3.

b. Invalid Stop Loss Treaty

The SLT with its parent, Commonwealth Insurance Company (CIC), is triggered by experiencing either an individual loss equivalent to 10% of CICA's statutory surplus or an aggregate loss, loss expense, and other underwriting expenses ratio (i.e. a combined ratio) exceeding 105% of earned premium within the covered calendar year.

The SLT is a non-reinsurance agreement according to the Statement of Statutory Accounting Principles (SSAP) No. 62, which states:

1.) Reinsurance is "...the assumption by an insurer of all or part of a risk undertaken originally by another insurance." (Paragraph 12.)

2.) "The essential ingredient of a reinsurance contract is the transfer of risk. The essential ingredient of every true reinsurance agreement is the undertaking by the reinsurer to indemnify the ceding company ...against loss or liability by reason of the original insurance." (Paragraph 9.)

The SLT provides reimbursement when the combined ratio target is exceeded. All past recoveries under the agreement have been based upon that aspect of the contract. The combined ratio is not directly related to "...loss or liability by reason of the original insurance." The combined ratio could exceed the target even if no "original insurance" was written and only the Company's infrastructure was in place and generating expenses. Therefore, the SLT is misclassified as reinsurance, because, in fact, it is a related-company agreement. The recordation and accounting for transactions under the SLT must be corrected to present a true picture of the Company's financial condition and to follow the AP&P.

In addition to the above deficiencies, the Company also failed to follow the procedures required under the Insurer Holding Company Act for any significant contract or reinsurance agreement. (See Instruction No. 2)

The Company is instructed to comply with RCW 48.05.073, which requires every insurer to file its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which states the annual statement shall adhere to the appropriate NAIC Annual Statement Instructions and the AP&P promulgated by the NAIC.

This examination adjustment requires reversing the accounting treatment of the SLT as reinsurance and establishing the $2,035,000 pending reimbursement under the agreement as a receivable from parent, with a credit to paid-in surplus. This is shown as examination adjustment number 4. The loss reserves and loss adjustments shall not be affected by SLT transactions and this accounting treatment is required for all future statutory filings.

2) Insurer Holding Company Act Violations

The examination team discovered several violations of the Insurer Holding Company Act, primarily related to a lack of disclosure and/or approval of intercompany arrangements by the OIC.

The Company is instructed to comply with RCW 48.31B.025 and RCW 48.31B.030, to properly disclose and file for approval or prior notice with the OIC certain arrangements among affiliates. The following exceptions were noted in our examination:

a. Stop Loss Treaty

In 1999, the Company entered into the SLT with its parent company, Commonwealth Insurance Company (CIC), which it considered to be a reinsurance contract. Our examination noted that this agreement did not meet the requirements of a valid reinsurance contract. (See Instruction No. 1b.)

Three filing issues were noted regarding this agreement:

1) Agreement never disclosed - the agreement has never been disclosed in the Company's Annual Form B filing, a violation of RCW 48.31B.025(2)(c), which states that an insurer should disclose agreements with its affiliates;

2) Cost of protection - the $500 cost of the protection to CICA is small in comparison to its potential benefits, and was not justified as fair and reasonable, as required by RCW 48.31B.030(1)(a)(i), and;

3) RCW 48.31B.030(1)(b) stipulates that certain agreements may not be executed unless prior approval is obtained from the Commissioner. Prior approval was not obtained for this agreement.

b. Investment Service Contract

The Company's 2003 filing of Form D disclosed that it had an investment and service contract between CICA and its affiliates, Hamblin Watsa and Fairfax. The Form D was filed on April, 15, 2003, well after the execution of the agreement on January 1, 2003. This violated the Insurer Holding Company Act, 48.31B.030(1)(b)(iv), which states that such a transaction "...may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into the transaction...".

c. Management Expenses

The Company has not consistently reported expenses from the allocation of management fees. CICA has a service contract with its parent, CIC. The contract allows for CIC to provide CICA with certain management and administrative services, supplies, and other miscellaneous expenses to operate the subsidiary. The management expenses are calculated as the lower of direct allocable costs to CICA or 25% of direct written premium. In 2002, the Company departed from its usual bookkeeping of the management expenses and reduced the management expenses by the portion of general expenses allocable to provisions for the Company's SLT with CIC. The reduction of management expenses based on the provisions of the SLT does not appear to be consistent with previous or subsequent years. The Company is instructed to calculate management expenses on a consistent basis.

3) NAIC Annual Statement Errors and Misclassifications

The examination team discovered several instances in which the Company's filing of the 2003 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions.

The Company is instructed to comply with RCW 48.05.073, RCW48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statement in accordance with the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions. The following exceptions were noted in our examination:

a. Reclassification of Commissions, Contingent Commissions and Other Similar Charges

The Company incorrectly reported a debit balance of $585,287 for Commissions Payable, Contingent Commissions and Other Similar Charges in the 2003 NAIC Annual Statement. The debit balance related to: 1) ceded commissions for $247,524, which should be a reduction to Ceded Reinsurance Premiums Payable, and 2) the Excess Loss Catastrophe clearing account balance of $342,498. An additional, unaudited amount of $4,735 makes up the remaining balance of the reported amount totaling $585,287. SSAP 62, paragraph 41 allows the entire amount as a reduction to Ceded Reinsurance Premiums Payable. (See Notes to the Financial Statements No. 5)

b. Allocation of Expenses

The Underwriting and Investment Exhibit, Part 3 - Expenses did not correctly reflect Loss Adjustment Expenses (LAE) during the examination period. Expense allocation rules require that a portion of the reported Other Underwriting Expenses be classified as LAE, as those general expenses assist in the adjudication of claims. Specifically, general expenses such as salary, employee relations, and rent should be allocated to both Other Underwriting Expenses and LAE based on studies or estimates to yield an accurate and reasonable cost allocation basis.

c. Schedule D - Verification Between Years

Schedule D - Verification Between Years did not properly disclose the non-admitted amounts of bonds and stocks for the Company's NAIC Annual Statement years 2003 and 2002.

d. Schedule DB – Hedging Transactions

In 2003, the Company purchased options to purchase fixed income securities, otherwise known as derivative investments. However, the securities held were not properly disclosed on Schedule DB of the NAIC 2003 Annual Statement.

4) Board of Directors

During the examination period, the Company changed the number of its members of the Board of Directors (BOD) from 5 to 3 members, a violation of RCW 48.06.200(5)(c)(sixth), which states that the number of directors "shall not be less than five in number".

The Company is instructed to comply with RCW 48.06.200(5)(c)(sixth) and increase the number of current BOD members to 5.

5) Investment Exceeded Limitations

The Company recorded in Schedule DA of the 2003 NAIC Annual Statement an investment of $5,235,553 for US Bank Government Money Market Fund. According to the 2003 SVO Manual, this fund is not listed as one of the funds that are backed by the full faith and credit of the US Government.

The US Bank investment of $5,235,553 represented more than 13.95% of the Company's total assets of $37,523,228. This amount exceeded the maximum amount that was allowed by RCW 48.13.030(1) by $3,734,624 and the excess has been non-admitted in the examination report. (See Notes to the Financial Statements No. 6)

The Company is instructed to comply with RCW 48.13.030(1) by limiting its investment in any single entity to four percent of its total assets.

COMMENTS AND RECOMMENDATIONS

1) Disaster Recovery Plan

The information systems department has the plans, skills, and ability to recover from an incident or disaster in a timely manner. However, the plans have not been fully documented in a written form, as promulgated by NAIC Guidelines.

It is recommended that the Company write, test, and implement a disaster recovery plan that includes appropriate escalation procedures to resolve operational failures in a timely manner.

COMPANY PROFILE

History

CICA was created by its parent, CIC, a Canadian property and casualty insurance company, with the purpose of entering the United States (U.S.) property and casualty market.

CICA specializes in underwriting medium to large commercial and industrial property risks; inland and ocean marine for all areas of the oil and gas industry, including petrochemicals; corporate and residential real estate; and casualty insurance as additional coverage for U.S. operations of CICA Canadian policyholders.

Territory and Plan of Operation

The Company has rapidly expanded its territory in the U.S. As of the last examination date, December 31, 1998, the Company had licenses to transact business in only four states. As of December 31, 2003, the Company had licenses in 45 states, including Washington, D.C., with direct written premiums in 40 states.

Growth of Company

The following schedules reflect the growth of the Company by year beginning in 1999:

Year	Admitted Assets	Liabilities	Capital & Surplus
2003	$37,523,228	$18,159,173	$19,364,055
2002	30,982,653	12,327,968	18,654,685
2001	30,795,060	7,201,659	23,593,401
2000	25,624,911	2,847,150	22,777,761
1999	26,170,679	2,927,465	23,243,214

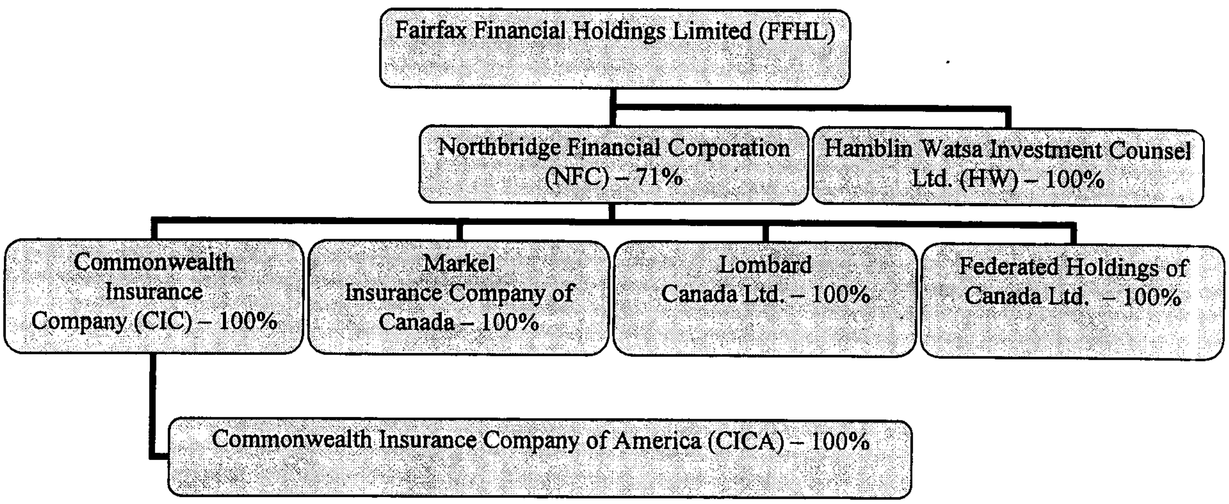
Year		Net Premiums Written		Net Underwriting Gains/(Losses)		Net Investment Gains (Losses)		Net Income
2003	$	8,317,527	$	(404,665)	$	1,768,672	$	610,301
2002		3,612,476		(334,476)		2,216,572		1,184,947
2001		1,914,346		(47,716)		1,440,814		842,051
2000		1,437,334		(99,003)		1,444,305		831,041
1999		1,073,772		(23,998)		1,381,761		867,648

AFFILIATED COMPANIES

The Company is 100% owned by its parent, CIC. CIC, in turn, is 100% owned by Northbridge Financial Corporation (NFC), a publicly traded company on the Toronto Stock Exchange. Fairfax Financial Holdings Limited (Fairfax or FFHL) owned, as of December 31, 2003, 71% of NFC, with the remaining share of the Company owned by investors.

FFHL created NFC in 2003 by combining four of its wholly-owned companies: Federated Holdings of Canada Ltd., Markel Insurance Company of Canada, Lombard Canada Ltd., and CIC. In May 2003, Fairfax distributed 29% of the Company in an initial public offering on the Toronto Stock Exchange (TSX). In May 2004, FFHL reduced its position in Northbridge from a 71% position to 59% by distributing an additional 6,000,000 shares on the TSX, which raised $146 million. No financial effect to CICA resulted.

The following organization chart illustrates the significant affiliates of CICA, as of December 31, 2003. Although FFHL has additional affiliates, this chart highlights affiliates that immediately affect CICA.



The Company has the following intercompany contracts:

1) Management and Service Contract with CIC – The agreement allows for CIC to provide CICA with certain management and general services, supplies and expenses to operate the subsidiary. The management expenses are calculated as the lower of direct allocable costs to CICA or 25% of direct written premium.

2) SLT with CIC – See reinsurance section.

3) Investment Contract with FFHL and Hamblin Watsa Investment Counsel, Ltd. (HW) – HW manages the Company's investment portfolio in accordance with Chapter 48.13 RCW. The fees charged by HW include a base fee and are approved through the Company's ultimate parent, Fairfax.

MANAGEMENT AND CONTROL

Ownership

The Company has 10,000,000 shares of common capital stock authorized at a $10 par value, with 300,000 shares outstanding for a common capital stock balance of $3,000,000. The Company is not publicly traded and is 100% owned by its immediate parent, CIC. The reported balance of gross paid-in and contributed surplus of $16,929,710 has not changed since the last examination, which was as of December 31, 1998. The last contribution to surplus was in 1996 by CIC for $11,928,710, in the form of stock, which was subsequently sold for cash in 1997. The remaining $5,001,000 was contributed by CIC when the Company was formed. No dividends or surplus notes have been distributed by CICA.

Board of Directors (BOD)

The following BOD were serving the Company as of December 31, 2003:

Name	Principal Occupation
Ronald G. Schwab	Chairman of the Board, President of CIC and CICA
Craig A. Hurford	Executive VP of CIC
Winslow W. Bennet	President of Winwood Holdings, Ltd.

CICA also has an audit and investment committee, which along with discussions of the BOD, are reviewed by CIC as considered necessary.

Officers

The following officers were serving the Company as of December 31, 2003:

Name	Position
Ronald G. Schwab	President

Edward P. Hunter	Executive Vice President
Craig A. Hurford	Executive Vice President
Thomas E. Wilson	Vice President
Noel E. Phillips	Treasurer
Donald M. Parry	Secretary/Controller

Conflict of Interest

The Company does not have any employees, as it operates with the use of CIC's employees. CIC has a Corporate Code of Conduct Policy, which requires conflict of interest questionnaires to be completed and signed by the directors, officers, and employees for disclosure of any potential conflicts. The signed statements are reviewed annually for conflicting situations and the BOD reviews any potential conflicting situations and takes appropriate action.

Fidelity Bond and Other Insurance

The NAIC suggested amount of fidelity insurance for CICA is between $350,000 and $400,000. CICA's ultimate parent, Fairfax, provides fidelity bond coverage for the Company. The coverage amount for all of Fairfax subsidiaries is $50,000,000 with a $10,000,000 deductible. The coverage levels for fidelity bond, and all other exposures, such as general liability and property coverages, appear reasonable and meet the recommended NAIC guidelines.

Officers', Employees', and Agents' Welfare and Pension Plans

As noted under the Conflict of Interest section of this report, the Company does not have any employees, as it operates with the use of CIC's employees. As of December 31, 2003, CICA reimbursed CIC based on either direct allocable costs or 25% of Net Written Premium. As such, no obligations to employees for pension or retirement plans are necessary for CICA.

CORPORATE RECORDS

The Company was incorporated on October 26, 1994 and commenced business on July 1, 1995, as a property and casualty insurance corporation domiciled in the state of Washington. The Articles of Incorporation were approved by the Insurance Commissioner, Washington State, and filed with the Secretary of State, Washington State.

The Company's Bylaws and Articles of Incorporation have changed since the last examination to reflect the prior report instructions for RCW and WAC violations. Additionally, CICA changed its Bylaws to reflect a change in the number of Board of Directors from 5 to 3. (See Instruction No. 4)

In a review of the Company's BOD minutes for the examination period 1998 through 2003, the directors approved and supported material transactions and events as required.

LOSS EXPERIENCE

Introduction

The OIC actuarial staff reviewed the reserves carried by CICA for unpaid losses and loss adjustment expenses as of December 31, 2003. The Company provided loss and loss adjustment expense development data by accident year and line of business, evaluated as of December 31, 2003. The OIC actuaries obtained additional information from meetings with several Company employees and reviewed actuarial reports prepared by its consulting actuary, in connection with the appointed actuary's Statements of Actuarial Opinion as of December 31, 2002 and December 31, 2003.

Stop Loss Treaties

The Company and its parent, CIC, annually re-execute the SLT capping the Company's combined (loss and expense) ratio for the current calendar year and accounting for the agreements as unauthorized reinsurance. For example, the combined ratio cap for 2003 was 105%. When the cap is exceeded in any given calendar year, the Company cedes losses to CIC. In its financial statements, the Company then records these ceded losses as if they are all from the current accident year.

Treating these SLT's as reinsurance makes it difficult to determine the adequacy of the Company's loss and loss adjustment expense reserves. The Company's consulting actuary maintains in his actuarial reports that the agreements reduce the range of indicated reserves to a single point. But claims from accident years 2003 and prior are still subject to further development. For example, there was substantial adverse loss development in the first quarter of 2004 on a 1999 claim for earthquake damage to the Grays Harbor County Courthouse. The Company's actuary assumes that future SLT's will prevent any net development on claims from accident years 2003 and prior. However, estimates of the adequacy of the Company's loss and loss adjustment expense reserves as of December 31, 2003, cannot be allowed to depend on the execution of similar SLT's in the future years, 2004 and beyond.

There is another significant concern. The re-executed stop-loss treaties prevent the Company from building up adequate loss and loss adjustment expense reserves. For example, in a year in which the combined ratio already exceeded the cap, there would be no point in increasing incurred but not reported (IBNR) reserves. The cap would cause the entire increase to be ceded to CIC, and the Company's net reserves would be unaffected. In fact, the Company actually sets negative net IBNR reserves, for both losses and loss adjustment expenses, in anticipation of the beneficial effects expected from future re-executed SLT's. (See Instruction No. 1)

REINSURANCE

CICA is a relatively new company organized under Fairfax Financial Holdings Limited, a large Canadian company. This group specializes in property and casualty insurance and reinsurance, and it provides overall direction and support to CICA via CIC.

Since CICA is a new, smaller company, which concentrates on medium to large commercial property risks, inland and ocean marine cover for the oil and gas industry, and casualty coverage for U. S. operations of Canadian companies, it is involved in large exposures relative to its capitalization. Accordingly, the risks are significant, so CICA shares in the reinsurance of its parent, CIC. This results in a comprehensive and complex array of coverage for both companies, which serves to mitigate the effects of CICA covering large exposures with limited capital.

The external treaties include Quota Share, per risk Excess of Loss and Surplus treaties, covering aspects of property, energy and marine risks. All contain the required insolvency clauses, plus various other provisions which are not abnormal for the types of reinsurance and coverage. Among the treaties are two reinsurance contracts containing loss participation clauses. These clauses require CICA to assume all losses in a band between 80% and 90% (First Surplus Treaty) or 80% and 95% (Quota Share Treaty) of the treaties' earned premium (EP). The reinsurers then resume assuming losses over those thresholds.

CICA's coverage and its relatively small capital leave its viability and solvency at risk. This is addressed by an agreement with CIC, which was mistakenly classified as a Stop Loss Treaty. The agreement with CIC provides a buffer for the Company's operations and has been triggered in both 2002 and 2003. It is triggered by a 105% combined ratio and has been effective in sustaining CICA's solvency. This agreement has now been determined to be an invalid reinsurance contract, as discussed in Instruction No. 1b. However, its function to guarantee CICA's solvency can only be effective so long as the agreement continues, even though it must be accounted for as an intercompany agreement, not as a reinsurance contract.

STATUTORY DEPOSITS

The Company maintained the following deposits as of December 31, 2003 in compliance with statutory and special requirements:

Location	Type of Security	Par Value	Statement Value	Market Value
Georgia	Money Market Fund	$25,000	$25,000	$25,000
New Hampshire	US Treasury Bond	500,000	632,420	623,731
New Hampshire	UST Money Market Fund	17,765	17,765	17,765
New Mexico	US Treasury Bond	300,000	386,536	381,938
Oklahoma	Oklahoma Bank Term Deposit	300,000	300,000	300,000
Virginia	US Treasury Bond	250,000	255,058	269,424
Total		$1,392,765	$1,616,779	$1,617,858

Special deposits which are held for the protection of the Policyholders:

Location	Type of Security	Par Value	Statement Value	Market Value
Washington	US Treasury Bond	$2,875,000	$2,933,165	$3,098,373
Washington	Tier Principal GOB	750,000	765,129	778,770
Washington	US Bank Money Market	510,364	510,364	510,364
Total		$4,135,364	$4,208,658	$4,387,507

Securities held by the state of Washington and other states were confirmed directly with the Company's authorized representatives.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a modified GAAP accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of PricewaterhouseCoopers. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of CICA is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The Company's IS department has the ability to recover from an incident or disaster, but has not documented these procedures in a detailed, written disaster recovery plan, previously noted as a report recommendation. (See Comments and Recommendations No. 4)

SUBSEQUENT EVENTS

In the first quarter of 2004, the Company lost a court ruling that forced it to increase the reserve for a 1999 earthquake loss for Grays Harbor County Courthouse. The reserve increased from $1,202,062 ($2,749,927 on a gross basis), as of December 31, 2003, to $2,593,556 ($7,559,834 on a gross basis), as of July 16, 2004. No other material events occurred subsequent to the examination date and prior to the end of field work.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The prior examination report instructions were satisfactorily addressed and corrected.

FINANCIAL STATEMENTS

COMMONWEALTH INSURANCE COMPANY OF AMERICA
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2003

Assets	BALANCE PER COMPANY	REF NOTE	EXAM ADJUSTMENT	BALANCE PER EXAM
Bonds	$ 4,882,411		$ 0	$ 4,882,411
Stocks:				
Common stocks	232,378			232,378
Cash and short-term investments	27,483,831	6	(3,734,624)	23,749,207
Subtotal, cash and invested assets	32,598,620		(3,734,624)	28,863,996
Investment income due and accrued	93,868			93,868
Premiums and considerations				
Uncollected premiums and agents' balances in course of collection	1,852,765			1,852,765
Reinsurance:				
Amounts recoverable from reinsurers	2,094,748			2,094,748
Receivable from parent, subsidiaries and affiliates	0	4	670,234	670,234
Current federal and foreign income tax recoverable and interest thereon	467,784			467,784
Net deferred tax asset	415,444			415,444
Total Assets	$ 37,523,229		$ (3,064,390)	$ 34,458,839
Liabilities, Surplus and other Funds				
Losses	$ 1,419,483	1	$ 4,655,450	$ 6,074,933
Loss adjustment expenses	191,450	2	905,550	1,097,000
Commissions payable, contingent commissions and other similar charges	(585,287)	5	585,287	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	262,879			262,879
Unearned premiums	5,293,536			5,293,536
Ceded reinsurance premiums payable	3,897,532	5	(585,287)	3,312,245
Provision for reinsurance	6,314,815	3	(2,035,000)	4,279,815
Payable to parent, subsidiaries and affiliates	1,364,766	4	(1,364,766)	0
Total Liabilities	18,159,174		2,161,234	20,320,408
Common capital stock	3,000,000			3,000,000
Gross paid in and contributed surplus	16,929,710	4	2,035,000	18,964,710
Unassigned funds (surplus)	(565,655)	1, 2, 3, 6	(7,260,624)	(7,826,279)
Surplus as regards policyholders	19,364,055		(5,225,624)	14,138,431
Total Liabilities, Surplus and other Funds	$ 37,523,229		$ (3,064,390)	$ 34,458,839

COMMONWEALTH INSURANCE COMPANY OF AMERICA
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2003

	BALANCE PER COMPANY	REF NOTE	EXAM ADJUSTMENT	BALANCE PER EXAM
STATEMENT OF INCOME				
Underwriting Income				
Premiums earned	$ 5,834,389		$ 0	$ 5,834,389
Deductions				
Losses incurred	3,107,976	1	4,655,450	7,763,426
Loss expenses incurred	373,604	2	905,550	1,279,154
Other underwriting expenses incurred	2,757,475		0	2,757,475
Total underwriting deductions	6,239,055		5,561,000	11,800,055
Net underwriting gain or (loss)	(404,666)		(5,561,000)	(5,965,666)
Investment Income				
Net investment income earned	526,399			526,399
Net realized capital gains or (losses)	1,242,274			1,242,274
Net investment gain or (loss)	1,768,673		0	1,768,673
Net income, after dividends to policyholders but before fed. And foreign income taxes	1,364,007		(5,561,000)	(4,196,993)
Federal and foreign income taxes incurred	753,706			753,706
Net income	**$ 610,301**		**$ (5,561,000)**	**$ (4,950,699)**
CAPITAL AND SURPLUS ACCOUNT				
Surplus as regards policyholders, December 31 prior year	$ 18,654,685			$ 18,654,685
Gains and (Losses) in Surplus				
Net income	610,301	1, 2, 3	($5,561,000)	(4,950,699)
Change in net unrealized capital gain/losses	(316,603)			(316,603)
Change in net deferred income tax	230,404			230,404
Change in nonadmitted assets	666,495	6	(3,734,624)	(3,068,129)
Change in provision for reinsurance	(481,226)	3	2,035,000	1,553,774
Surplus adjustments - Paid in	0		2,035,000	2,035,000
Change in surplus as regards policyholders for the year	709,371		(5,225,624)	(4,516,253)
Surplus as regards policyholders, December 31 current year	**$ 19,364,055**		**$ (5,225,624)**	**$ 14,138,431**

COMMONWEALTH INSURANCE COMPANY OF AMERICA
*RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE THE LAST EXAMINATION
FOR THE YEAR ENDED DECEMBER 31,

	2003	2002	2001	2000	1999
Capital and surplus, December 31, previous year	$ 18,654,684	$ 23,593,400	$ 22,777,761	$ 23,243,214	$ 22,093,010
Net income	610,301	1,184,947	842,051	831,041	867,648
Net unrealized capital gains or (losses)	(316,603)	(51,895)	0	0	0
Change in net deferred income tax	230,404	38,415	64,492	0	0
Change in nonadmitted assets	666,495	(1,395,493)	(26,769)	0	0
Change in provision for reinsurance	(481,226)	(4,714,690)	(157,790)	172,906	266,156
Change in excess of statutory reserves over statement reserves	0	0	0	30,600	16,400
Cumulative effects of changes in accounting principles	0	0	93,655	0	0
Dividends to stockholders (cash)	0	0	0	(1,500,000)	0
Change in surplus as regards policyholders for the year	709,371	(4,938,716)	815,639	(465,453)	1,150,204
Surplus as regards policyholders, December 31, current year	$ 19,364,055	$ 18,654,684	$ 23,593,400	$ 22,777,761	$ 23,243,214

* = compiled from Company filed NAIC Annual Statements

COMMONWEALTH INSURANCE COMPANY OF AMERICA
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE EXAMINATION
AS OF DECEMBER 31, 2003

	PER COMPANY	PER EXAM	EXAMINATION ADJUSTMENT REF NOTE	INCREASE (DECREASE) IN SURPLUS	TOTAL
Capital and Surplus, December 31, 2003 - Per NAIC Annual Statement					**$ 19,364,055**
ASSETS					
Cash & short-term investments.	27,483,831	23,749,207	6	(3,734,624)	
Receivable from parent, subsidiaries and a	-	670,234	4	670,234	
LIABILITIES					
Losses	1,419,483	6,074,933	1	4,655,450	
Losses adjustment expenses	191,450	1,097,000	2	905,550	
Commission Payable	(585,287)	-	5	585,287	
Ceded reinsurance premium Payable	3,897,532	3,312,245	5	(585,287)	
Provision for reinsurance	6,314,815	4,279,815	3	(2,035,000)	
Payable to parent, subsidiaries and affiliat	1,364,766	-	4	(1,364,766)	
Change in surplus					(5,225,624)
Capital and Surplus, December 31, 2003 - Per Examination					**$ 14,138,431**

NOTES TO THE FINANCIAL STATEMENTS

1) Losses

The OIC actuary recommends an examination adjustment increasing Loss and Loss Adjustment Expense reserves by $5,561,000. Of this amount, losses were determined to be understated by $4,655,450, resulting in an examination balance of $6,074,933. (See Instruction No. 1a.)

2) Loss Adjustment Expenses

The OIC actuary recommends an examination adjustment increasing Loss and Loss Adjustment Expense reserves by $5,561,000. Of this amount, Loss Adjustment Expenses were determined to be understated by $905,550, resulting in an examination balance of $1,097,000. (See Instruction No. 1a.)

3) Reinsurance Deficiencies

The Company entered annual Stop Loss Treaty (SLT) contracts with CIC to cap its combined ratio, generally at 105%. These contracts did not meet the definition of SSAP Number 62, which requires reinsurance to be based upon original underlying insurance contracts, not combined ratios. Consequently this agreement is not to be accounted for as reinsurance and the $2,035,000 provision for unauthorized reinsurance is restored to Unassigned funds. (See Instruction No. 1a.)

4) Invalid Stop Loss Treaty

Because the intragroup SLT contract does not qualify as a reinsurance agreement under SSAP number 62, the $2,035,000 receivable under the contract is recorded as a Receivable from parent (resulting in a $670,234 debit balance, after eliminating a $1,364,766 liability to parent), with an offsetting credit to Gross paid in and contributed surplus. (See Instruction No. 1b.)

5) Commissions Payable, Contingent Commissions and Other Similar Charges

The Company incorrectly reported a debit balance of $585,287 for Commissions Payable, Contingent Commissions and Other Similar Charges in the 2003 NAIC Annual Statement. The negative balance related to 1) ceded commissions for $247,524, which should be a reduction to Ceded Reinsurance Premiums Payable, and 2) Excess Loss Catastrophe clearing account for $342,498 (which has been properly classified as due to parent, but incorrectly included in the adjustment). An additional, unidentified amount of $4,735 balances the reported amount of $585,287. Statements of Statutory Accounting Principles (SSAP) 62, paragraph 41 allows the entire amount as a reduction to Ceded reinsurance premiums payable. (See Instruction No. 3a.)

6) <u>Investments</u>

The Company's investment in US Bank Government Money Market Fund exceed the maximum amount that is allowed by RCW 48.13.030(1), which states that a domestic insurance company shall not have investments in one entity in an amount exceeding more than 4% of its total assets unless the investment is backed by the full faith of the United States Government. According to the 2003 SVO Manual, US Bank Government Money Market Fund is not listed as one of the funds that are backed by the full faith and credit of the US Government.

Therefore, an examination adjustment was made, reducing the admitted amount of the Company's investments in US Bank Government Money Market Fund to 4% of the Company's total admitted assets or an adjustment of $3,734,624. (See Instruction No. 6)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Commonwealth Insurance Company of America during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; CJ Mitchell, CPA, MBA, Examiner-in-Charge, John Gaynard, CPA, CFE, CPCU, Reinsurance Specialist; Jeanette Liao; Tarik M. Subbagh, CPA, Insurance Examiners; Lee Barclay, FCAS, MAAA, Senior Actuary; Eric Slavich, Actuarial Analyst; and John Jacobson, AFE, Information Systems Specialist, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

Timoteo L. Navaja, CPE, CIE
Examiner in Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
} ss
COUNTY OF KING }

Timoteo L. Navaja, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Commonwealth Insurance Company of America was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Timoteo L. Navaja, CFE, CIE
Examiner in Charge
State of Washington

Subscribed and sworn to before me this 21st day of June, 2005.

Notary Public in and for the
State of Washington.

COLLEEN JANSEN
COMMISSION EXPIRES
NOTARY PUBLIC
5-17-08
STATE OF WASHINGTON